

**MARKET CONDUCT EXAMINATION REPORT**  
**AS OF JUNE 30, 2002**

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**Pacific Employers Insurance Company**  
**1601 Chestnut Street**  
**Philadelphia, Pennsylvania 19103**

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**NAIC Group Code 0626**  
**NAIC Company Code 22748**

**EXAMINATION PERFORMED BY**  
**INDEPENDENT CONTRACTORS**  
**FOR**  
**COLORADO DEPARTMENT OF REGULATORY AGENCIES**  
**DIVISION OF INSURANCE**

July 14, 2004

The Honorable Doug Dean  
Commissioner of Insurance  
State of Colorado  
1560 Broadway, Suite 850  
Denver, Colorado 80202

Commissioner Dean:

In accordance with Sections 10-1-203 and 10-3-1106, C.R.S., an examination of selected underwriting, auditing and unit statistical card practices of the workers' compensation insurance business of Pacific Employers Insurance Company, hereinafter referred to as the "Company", has been conducted. The Company's records were examined at its home office located at 1601 Chestnut Street, Philadelphia, Pennsylvania 19103.

The examination covered the period from July 1, 2001 to June 30, 2002.

The following market conduct examiners respectfully submit the results of this examination:

Lucille E. Whittle, CIE

K. C. Lang, AIE

**MARKET CONDUCT  
EXAMINATION REPORT  
OF  
PACIFIC EMPLOYERS INSURANCE COMPANY**

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**COMPANY PROFILE**

The Company was incorporated under the laws of California on July 17, 1923. On July 1996, the Company changed its place of domicile to Philadelphia, Pennsylvania. The Company was first licensed in Colorado on September 17, 1940. Pacific Employers was acquired by the INA Group in 1965. It became part of the CIGNA Corporation in 1982 with the consolidation of the INA and Connecticut General Groups.

Pacific Employers Insurance Company is now a member of the ACE Group of Companies, which are stock companies. The Company was acquired by the ACE Group of Companies in July 1999, when ACE acquired the property and casualty business of the CIGNA Group of Companies.

The Company is licensed to operate in all states, the District of Columbia, and the United States Virgin Islands. It is authorized to write both personal and commercial lines of insurance; however, its present writings focus on commercial lines.

Based on figures supplied by the Colorado Division of Insurance's Industry Statistical Report, the Company reported direct written premium in Colorado for the calendar year 2001 of \$6,807,000, which represents a .79% market share for workers' compensation insurance. These figures were \$9,093,000 and 1.01%, respectfully in 2002.

**PURPOSE AND SCOPE OF EXAMINATION**

This market conduct report was prepared by independent examiners contracting with the Colorado Division of Insurance for the purpose of auditing certain business practices of insurers licensed to conduct the business of insurance in the State of Colorado. This examination is in accordance with Colorado Insurance Law Section 10-1-204, C.R.S., which empowers the Commissioner to supplement his resources to conduct market conduct examinations. The findings in this report, including all work product developed in the production of this report, are the sole property of the Colorado Division of Insurance.

The purpose of this examination was to determine the Company's compliance with Colorado insurance laws and with generally accepted operating principles related to workers' compensation. Examination information contained in this report should serve only those purposes. The conclusions and findings of this examination report are public record. The preceding statements are not intended to limit or restrict the distribution of this report.

This examination was governed by, and performed in accordance with, procedures developed by the National Association of Insurance Commissioners, the Colorado Division of Insurance and the Insurance Regulatory Examiners Society. In reviewing material for this report, the examiners relied primarily on records and materials maintained by the Company. The examination period covered one year of the Company's operations, from July 1, 2001 to June 30, 2002.

File sampling was based on a review of audited policies, with accompanying claims, and claims for policies with large and small deductibles. Samples were systematically selected by using ACL™ software and computer data files provided by the Company. Sample sizes were chosen based on procedures developed by the National Association of Insurance Commissioners. Upon review of each sampled policy and claim, any concerns or discrepancies were noted on comment forms and these comment forms were delivered to the Company for review. Once the Company was advised of a finding contained in a comment form, the Company had the opportunity to respond. For each finding the Company was requested to agree or disagree and justify the Company's noted action. At the conclusion of the examination, the Company was provided a summary of the findings for each sample. The report of the examination is, in general, a report by exception. Therefore, much of the material reviewed will not be contained in this written report as references to any practices, procedures, or files manifesting no errors were omitted.

An error tolerance level of plus or minus ten dollars (\$10.00) was allowed in most cases where monetary values were involved. However, in cases where monetary values were generated by computer or other systemic methodology, a zero (\$0) tolerance level was applied in order to identify possible system errors. Additionally a zero (\$0) tolerance level was applied in instances where there appeared to be a consistent pattern of deviation from the Company's established policies, procedures, rules and/or guidelines. When sampling was involved, a minimum error tolerance level of five percent (5%) was established to determine reportable exceptions. However, if an issue appeared to be systemic, or when due to the sampling process it was not feasible to establish an exception percentage, a minimum error tolerance percentage was not utilized. Also, if more than one sample was reviewed in a particular area of the examination (e.g. timeliness of claims payment), and if one or more of the samples yielded an exception rate of five percent (5%) or more, the results of any other samples with exceptions percentages less than five percent (5%) were also included.

This report contains information regarding exceptions to Colorado insurance laws. The examination included review of the following three (3) Company operations:

1. Company Operations/Management
2. Underwriting and Rating
3. Unit Statistical Card Reporting

All unacceptable or non-complying practices may not have been discovered during the course of this examination. Additionally, findings may not be material to all areas that would serve to assist the Commissioner. Failure to identify or criticize specific Company practices does not constitute acceptance by the Colorado Division of Insurance of such practices. This report should not be construed to endorse or discredit any insurance company or insurance product. Statutory cites and regulation references are as of the period under examination unless otherwise noted. Examination report recommendations not referencing specific insurance laws and/or regulations may be presented to encourage improvement in Company practices and operations and ensure consumer protection. Examination findings may result in administrative action by the Division of Insurance.

**EXAMINERS' METHODOLOGY**

The examiners reviewed the Company's Workers' Compensation underwriting and unit statistical card reporting practices to determine compliance with Colorado insurance law as outlined in Exhibit 1.

**Exhibit 1**

<b>Law</b>	<b>Subject</b>
Section 10-3-1103	Unfair methods of competition and unfair or deceptive acts or practices prohibited.
Section 10-4-1104	Unfair methods of competition and unfair or deceptive acts or practices.
Section 10-4-110	Notice of intent prior to nonrenewal of certain policies of insurance.
Section 10-4-110.5	Notice of intent prior to unilateral increase in premium or decrease in coverage previously provided of certain policies of insurance.
Section 10-4-113	Exemptions.
Section 10-4-401	Purpose – applicability.
Section 10-4-413	Records required to be maintained.
Section 10-4-416	Prohibiting changes in rates or coverages.
Section 10-4-421	Notice of rate increases and decreases.
Regulation 1-1-7	Market Conduct Record Retention
Regulation 1-1-8	Penalties And Timelines Concerning Division Inquiries And Document Requests.
Regulation 5-1-11	Risk Modification Plans
Regulation 5-3-1	Workers' Compensation Risk Management Regulation
Regulation 5-3-2	Workers' Compensation Insurance Data Reporting Regulation
Regulation 5-3-3	Concerning Workers' Compensation Deductible Policies in Excess of \$5,000
Regulation 5-3-4	Concerning Standards for Not-At-Fault Motor Vehicle Accidents Under Workers' Compensation, Loss Limitation in Calculating Experience Modifications and Distribution of Losses in Excess of The Loss Limitation
Regulation 5-3-5	Workers' Compensation Deductible Reimbursement

**Company Operations/Management**

The examiners reviewed Company implementation and quality controls, record retention, and timely cooperation with the examination process.

**Contract Forms and Endorsements**

Forms and endorsements used by the Company in writing Workers' Compensation policies containing Colorado exposures are those filed with the Colorado Division of Insurance by the National Council on Compensation Insurance (NCCI) and no review of these forms was made.

**Audited Policies**

For the period under examination, the examiners systematically selected the following underwriting samples to determine compliance with underwriting and rating requirements:

<b>Review Lists</b>	<b>Population</b>	<b>Sample Size</b>	<b>Percentage to Population</b>
Audited Policies with Experience Modifiers	182	50	27%
Audited Policies without Experience Modifiers	10	10	100%

**Underwriting and Rating**

The examiners reviewed the rate and rule filings, statistical justifications, and methodology submitted to the Colorado Division of Insurance for the period under examination. This information was then compared against samples of audited policies with experience modifiers and audited policies without experience modifiers to determine compliance with NCCI loss costs, filed loss costs factors, audited payroll information, experience modifiers, schedule rating, officer and sole proprietor payrolls, and Colorado cost containment and designated medical provider requirements.

**Unit Statistical Card Reporting**

For the period under examination, the examiners systematically selected the following samples of claims from audited policies with experience modifiers and from policies with large and small deductibles to determine compliance with NCCI unit statistical card reporting requirements:

<b>Review Lists</b>	<b>Population</b>	<b>Sample Size</b>	<b>Percentage to Population</b>
Claims from Audited Policies with Experience Modifiers	554	372	67%
Additional Claims from Policies with Large and Small Deductibles	127	121	95%

**EXAMINATION REPORT SUMMARY**

The examination resulted in a total of seven (7) issues arising from the Company's apparent failure to comply with Colorado insurance laws that govern all property and casualty insurers operating in the State of Colorado. These issues involved the following Company operations:

**Company Operations/Management**

In the area of Company operations/management, one (1) compliance issue is addressed in this report. This issue arises from Colorado statutory and regulatory requirements that must be followed when writing workers' compensation policies containing Colorado exposures. In regard to this one (1) practice, it is recommended that the Company review its record retention procedures and make the necessary changes to ensure future compliance with applicable Colorado insurance laws.

The compliance issue addressed in this phase is as follows:

- Failure of the Company, in some cases, to maintain records required when writing workers' compensation policies containing Colorado exposures.

**Underwriting and Rating**

In the area of underwriting and rating, five (5) compliance issues are addressed in this report. These issues arise from Colorado statutory and regulatory requirements that must be followed when writing workers' compensation policies containing Colorado exposures. In regard to these five (5) underwriting and rating practices, it is recommended that the Company review its underwriting and rating procedures and make the necessary changes to ensure future compliance with applicable Colorado insurance laws.

The five (5) compliance issues addressed in this phase are as follows:

- Failure of the Company to attach a form to policies which shows the potential savings available when an insured obtains cost containment certification by the Colorado Workers' Compensation Cost Containment Board and to require the insured to indicate its awareness of this program on a form and to retain this form in the insured's underwriting file.
- Failure of the Company to require each insured to indicate on a form their awareness of the premium differential available when an insured selects a designated medical provider and to retain this form in the insured's underwriting file.
- Failure of the Company, in some cases, to use experience modification factors promulgated by NCCI.
- Failure of the Company, in some cases, to apply the correct rating methodology when rating workers' compensation policies with Colorado exposures.
- Failure of the Company to file its dividend plan as required by Colorado insurance law.

**Unit Statistical Card Reporting**

In the area of unit statistical card reporting, one (1) compliance issue is addressed in this report. This issue arises from Colorado statutory and regulatory requirements that must be followed when writing workers' compensation policies containing Colorado exposures. In regard to this one (1) unit statistical card reporting practice, it is recommended that the Company review its unit statistical card reporting procedures and make the necessary changes to ensure future compliance with applicable Colorado insurance laws.

The one (1) compliance issue addressed in this phase is as follows:

- Failure of the Company, in some cases, to correctly report unit statistical card information to NCCI.

A copy of the Company's response, if applicable, can be obtained by contacting the Company or the Colorado Division of Insurance.

Results of any previous Market Conduct Examinations are available on the Colorado Division of Insurance's website at [www.dora.state.co.us/insurance](http://www.dora.state.co.us/insurance) or by contacting the Colorado Division of Insurance.

**MARKET CONDUCT EXAMINATION REPORT**

**FACTUAL FINDINGS**

**PACIFIC EMPLOYERS INSURANCE COMPANY**

**OPERATIONS/MANAGEMENT**  
**FINDINGS**

**Issue A: Failure of the Company, in some cases, to maintain records required when writing workers' compensation policies which contain Colorado exposures.**

Section 10-4-413, C.R.S., Records required to be maintained, states in part:

(1) Every insurer...shall maintain reasonable records, of the type and kind reasonably adapted to its method of operation, of its experience or the experience of its members and of the data, statistics, or information collected or used by it in connection with the rates, rating plans, rating systems, underwriting rules, policy or bond forms, surveys, or inspections made or used by it, so that such records will be available at all reasonable times to enable the commissioner to determine whether such organization, insurer, group, or association and, in the case of an insurer or rating organization, every rate, rating plan, and rating system made or used by it complies with the provisions of this part 4 applicable to it. ...Such records shall be maintained in an office within this state or shall be made available for examination or inspection by the commissioner at any time, upon reasonable notice.

Colorado Regulation 1-1-7, Market Conduct Record Retention, promulgated under the authority of Section 10-1-109, C.R.S., states, in part:

**(B) RECORDS REQUIRED FOR MARKET CONDUCT PURPOSES**

1. Every insurer/carrier or related entity licensed to do business in this state shall maintain its books, records, documents and other business records so that the insurer's/carrier's or related entity's claims, rating, underwriting, marketing, complaint, and producer licensing records are readily available to the Commissioner. Unless otherwise stated within this regulation, records shall be maintained for the current calendar year plus two calendar years.
2. A policy record shall be maintained for each policy issued in this state. Policy records shall be maintained for the current policy term, plus two calendar years, unless otherwise contractually required to be retained for a longer period. Provided, however, documents from policy records no longer required to be maintained under this regulation, which are used to rate or underwrite a current policy, must be maintained in the current policy records. Policy records shall be maintained so as to show clearly the policy term, basis for rating and, if terminated, return premium amounts, if any. Policy records need not be segregated from the policy records of other states so long as they are readily available to the commissioner as required under this rule. A separate copy need not be maintained in the individual policy records, provided that any data relating to that policy can be retrieved. Policy records shall include:
  - a. The application for each policy, if any;
  - b. Declaration pages, endorsements, riders, termination notices, guidelines or manuals associated with or used for the rating or underwriting of the policy. Binder(s) shall be retained if a policy was not issued; and

c. Other information necessary for reconstruction of the rating and underwriting of the policy.

Colorado Regulation 5-1-11, Risk Modification Plans, promulgated under the authority of Section 10-1-109, 10-4-401, 10-4-403, 10-4-404, and 10-4-408, C.R.S., states, in part:

(III) RULES

(A) Definitions...

(13) "Rate modification plan" (commonly called Schedule Rating Plan or Individual Risk Premium Modification Plan) means a rating plan or procedure which provides a listing of various risk characteristics or conditions and a range of modification factors which may be applied for these characteristics or conditions to the manual rate of a particular insurance risk...

B. Rate modification plans, justified according to the standards herein, are permitted. However, the Commissioner has determined that the use of unjustified rate modification plans is not reasonable, is not objective and is unfairly discriminatory. Therefore, the use of unjustified rate modification plans in rating of commercial property and casualty insurance risks located in Colorado is prohibited.

The following elements shall be considered in determining whether or not a rate modification plan, or its use, is justified...

4. Individual underwriting files must contain the specific criteria and document the particular circumstances of the risk that support each debit and credit. This documentation must exist in the individually rated risk file to enable the Commissioner to verify compliance with this regulation. Documentation may include, but is not limited to, inspection reports, photographs, agent observations and findings, insured's formal safety plans, premises evaluations and narrative reports covering other aspects of the risk...

The following charts illustrate the significance of errors versus the populations and samples examined:

**WORKERS' COMPENSATION POLICIES WITH EXPERIENCE MODIFIERS  
WRITTEN JULY 1, 2001 TO JUNE 30, 2002**

<b>Population</b>	<b>Sample Size</b>	<b>Number of Exceptions</b>	<b>Percentage to Sample</b>
182	50	12	24%

An examination of fifty (50) audited policies with experience modifiers, representing 27% of all workers' compensation audited policies with experience modifiers which contained Colorado exposures, written by the Company during the period July 1, 2001 to June 30, 2002, showed twelve (12) exceptions (or 24% of the sample) in which policy files did not contain a breakdown and/or justification for the schedule credit applied to the policy.

**WORKERS' COMPENSATION POLICIES WITHOUT EXPERIENCE MODIFIERS  
WRITTEN JULY 1, 2001 TO JUNE 30, 2002**

<b>Population</b>	<b>Sample Size</b>	<b>Number of Exceptions</b>	<b>Percentage to Sample</b>
10	10	3	30%

An examination of ten (10) audited policies without experience modifiers, representing 100% of all workers' compensation audited policies without experience modifiers which contained Colorado exposures, written by the Company during the period July 1, 2001 to June 30, 2002, showed three (3) exceptions (or 30% of the sample), in which policy files did not contain justification for the schedule credit applied to the policy.

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**Recommendation #1**

Within thirty (30) days, the Company should provide documentation demonstrating why it should not be considered in violation of Section 10-4-413, C.R.S., and Colorado Regulations 1-1-7 and 5-1-11. If the Company is unable to provide such documentation, it should be required to provide written evidence to the Colorado Division of Insurance that it has modified its procedures to ensure all required records are maintained when writing workers' compensation policies containing Colorado exposures in compliance with Colorado insurance laws.

**UNDERWRITING AND RATING**  
**FINDINGS**

**Issue B: Failure of the Company to attach a form to policies which shows the potential savings available when an insured obtains cost containment certification by the Colorado Workers' Compensation Cost Containment Board and to require the insured to indicate its awareness of this program on a form and to retain this form in the insured's underwriting file.**

Colorado Regulation 5-1-11, Risk Modification Plans, promulgated pursuant to the authority of Section 10-1-109, 10-4-401, 10-4-403, 10-4-404, and 10-4-408, C.R.S., states, in part:

(III) RULES...

(D) Workers' Compensation Cost Containment Disclosures

All workers' compensation insurers, including the Colorado Compensation Insurance Authority, shall disclose the availability of cost containment certification by the Colorado Workers' Compensation Cost Containment Board *and the potential premium savings on the face of the insurance policy or in a separate disclosure form attached as an addendum to the policy.* Such disclosure applies regardless of whether or not a risk is experience or schedule rated. *Insurers shall require that the insured business entity indicate on a form developed by the insurer, which states that the business entity is aware of the premium dividend if the business entity's risk management program is certified by the Colorado Cost Containment Board. This form shall be made part of the insured business entity's underwriting file.* (Emphases added.)

The following charts illustrate the significance of errors versus the populations and samples examined:

**WORKERS' COMPENSATION POLICIES WITH EXPERIENCE MODIFIERS – WRITTEN  
JULY 1, 2001 TO JUNE 30, 2002**

Population	Sample Size	Number of Exceptions	Percentage to Sample
182	50	50	100%

An examination of fifty (50) files, representing 27% of all workers' compensation audited policies with experience modifiers which contained Colorado exposures, written by the Company during the period July 1, 2001 to June 30, 2002, showed fifty (50) exceptions (or 100% of the sample) where no form was attached to the policy which showed the potential savings available when the insured obtains cost containment certification by the Colorado Workers' Compensation Cost Containment Board and no form on which the insured had indicated its awareness of this program was found in the insured's underwriting file. These potential savings are usually expressed as percentages.

**WORKERS' COMPENSATION POLICIES WITHOUT EXPERIENCE MODIFIERS –  
WRITTEN JULY 1, 2001 TO JUNE 30, 2002**

<b>Population</b>	<b>Sample Size</b>	<b>Number of Exceptions</b>	<b>Percentage to Sample</b>
10	10	10	100%

An examination of ten (10) audited policies without experience modifiers, representing 100% of all workers' compensation audited policies without experience modifiers which contained Colorado exposures, written by the Company during the period July 1, 2001 to June 30, 2002, showed ten (10) exceptions (or 100% of the sample) where no form was attached to the policy which showed the potential savings available when the insured obtains cost containment certification by the Colorado Workers' Compensation Cost Containment Board and no form on which the insured had indicated its awareness of this program was found in the insured's underwriting file. These potential savings are usually expressed as percentages.

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**Recommendation #2**

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Colorado Regulation 5-1-11. In the event the Company is unable to provide such documentation, it should be required to provide written procedures to the Colorado Division of Insurance which will ensure that it will attach a form *which shows the potential savings available* for certification by the Colorado Workers' Compensation Cost Containment Board to each insured's policy and will retain a copy of the form on which the insured has indicated its awareness of this program in the insured's underwriting file in compliance with Colorado insurance laws.

**Issue C: Failure of the Company to require each insured to indicate on a form their awareness of the premium differential available when an insured selects a designated medical provider and to retain this form in the insured's underwriting file.**

Colorado Regulation 5-1-11, Risk Modification Plans, promulgated pursuant to the authority of Section 10-1-109, 10-4-401, 10-4-403, 10-4-404, and 10-4-408, C.R.S., states, in part:

(III) RULES...

(D)...On an annual basis, all workers' compensation insurers, including the Colorado Compensation Insurance Authority, shall disclose the premium differential on the face of the insurance policy or in a separate disclosure form attached as an addendum to the policy when the policyholder has selected a designated medical provider. Such disclosure applies regardless of whether a risk is experience rated or schedule rated. *Insurers shall require that the insured business entity indicate on a form developed by the insurer, which states that the business entity is aware of the premium differential for selecting a designated medical provider. This form shall be made part of the insured business entity's underwriting file.* (Emphases added.)

The following charts illustrate the significance of errors versus the populations and samples examined:

**WORKERS' COMPENSATION POLICIES WITH EXPERIENCE MODIFIERS – WRITTEN  
JULY 1, 2001 TO JUNE 30, 2002**

Population	Sample Size	Number of Exceptions	Percentage to Sample
182	50	50	100%

An examination of fifty (50) audited policies with experience modifiers, representing 27% of all workers' compensation audited policies with experience modifiers which contained Colorado exposures, written by the Company during the period July 1, 2001 to June 30, 2002, showed fifty (50) exceptions (or 100% of the sample) in which no form on which the insureds could indicate their awareness of the premium differential given if they select a designated medical provider was found in the underwriting files. This premium differential is generally expressed as a percentage.

**WORKERS' COMPENSATION POLICIES WITHOUT EXPERIENCE MODIFIERS –  
WRITTEN JULY 1, 2001 TO JUNE 30, 2002**

Population	Sample Size	Number of Exceptions	Percentage to Sample
10	10	10	100%

An examination of ten (10) audited policies without experience modifiers, representing 100% of all workers' compensation audited policies without experience modifiers which contained Colorado exposures, written by the Company during the period July 1, 2001 to June 30, 2002, showed ten (10) exceptions (or 100% of the sample) in which no form on which the insureds could indicate their awareness of the premium differential given if they select a designated medical provider was found in the underwriting files. This premium differential is generally expressed as a percentage.

**Recommendation #3**

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Colorado Regulation 5-1-11. In the event the Company is unable to provide such documentation, it should be required to provide written procedures to the Colorado Division of Insurance which will ensure that the Company will retain a copy of the form on which the insured has indicated its awareness of the premium differential available if they select a designated medical provider in the insured's underwriting file in compliance with Colorado insurance laws.

**Issue D: Failure of the Company, in some cases, to use experience modification factors promulgated by NCCI.**

Section 10-3-1104, C.R.S., Unfair methods of competition and unfair or deceptive acts or practices states, in part:

(1) The following are defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance...

(f)(II) Making or permitting any unfair discrimination between individuals of the same class or between neighborhoods within a municipality and of essentially the same hazard in the amount of premium, policy fees, or rates, charged for any policy or contract of insurance, or in the benefits payable thereunder, or in any of the terms or conditions of such contract, or in any other manner whatever;

Section 10-4-413, C.R.S., Records required to be maintained, states, in part:

(1) Every insurer, rating organization, or advisory organization and every group, association, or other organization of insurers which engages in joint underwriting or joint reinsurance shall maintain reasonable records, of the type and kind reasonably adapted to its method of operation, of its experience or the experience of its members and of the data, statistics, or information collected or used by it in connection with the rates, rating plans, rating systems, underwriting rules, policy or bond forms, surveys or inspections made or used by it, so that such records will be available at all reasonable times to enable the commissioner to determine whether such organization, insurer, group, or association and, in the case of an insurer or rating organization, every rate, rating plan, and rating system made or used by it complies with the provisions of this part 4 applicable to it. The maintenance of such records in the office of a licensed rating organization of which an insurer is a member or subscriber will be sufficient compliance with this section for any insurer maintaining membership or subscribership in such organization to the extent that the insurer uses the rates, rating plans, rating systems, or underwriting rules of such organization. Such records shall be maintained in an office within this state or shall be made available for examination or inspection by the commissioner at any time, upon reasonable notice.

NCCI's Experience Rating Plan Manual states in part:

Part One – Page 1

I.A.6. Issuance of Modification

The experience modification for experience rated risks shall be calculated and issued by the appropriate rating organization listed in the Appendix.

The following chart illustrates the significance of errors versus the population and sample examined:

**WORKERS' COMPENSATION POLICIES WITH EXPERIENCE MODIFIERS WRITTEN  
JULY 1, 2001 TO JUNE 30, 2002**

<b>Population</b>	<b>Sample Size</b>	<b>Number of Exceptions</b>	<b>Percentage to Sample</b>
182	50	13	26%

An examination of fifty (50) audited policies with experience modifiers, representing 27% of all workers' compensation audited policies with experience modifiers which contained Colorado exposures, written by the Company during the period July 1, 2001 to June 30, 2002, showed thirteen (13) exceptions (or 26% of the sample) in which the experience modification factor used was not the one promulgated by NCCI.

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**Recommendation #4**

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Sections 10-3-1104 and 10-4-413, C.R.S. In the event the Company is unable to provide such documentation, it should be required to provide written procedures to the Colorado Division of Insurance which will ensure that all workers' compensation policies written that have Colorado exposures will contain the experience modification factors promulgated by NCCI in compliance with Colorado insurance laws.

**Issue E: Failure of the Company, in some cases, to apply the correct rating methodology when rating workers' compensation policies with Colorado exposures.**

Section 10-4-401, C.R.S., Purpose – applicability, states, in part:

(3) The kinds of insurance subject to this part 4 shall be divided into two classes, as follows...

(b) Type II kinds of insurance, regulated by open competition between insurers, including fire, casualty, inland marine, title insurance, and all other kinds of insurance subject to this part 4 and not specified in paragraph (a) of this subsection (3), including the expense and profit components of workers' compensation insurance, which shall be subject to all the provisions of this part 4 except for sections 10-4-405 and 10-4-406. Concurrent with the effective date of new rates, type II insurers shall file rating data, as provided in section 10-4-403, with the commissioner.

Additionally, Section 10-3-1104, C.R.S., Unfair methods of competition and unfair or deceptive acts or practices, states, in part:

(1) The following are defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance...

(f)(II) Making or permitting any unfair discrimination between individuals of the same class or between neighborhoods within a municipality and of essentially the same hazard in the amount of premium, policy fees, or rates, charged for any policy or contract of insurance, or in the benefits payable thereunder, or in any of the terms or conditions of such contract, or in any other manner whatever;

Regulation 5-1-10, Rate and Rule Submissions Property and Casualty Insurance, promulgated pursuant to the authority of Sections 10-1-109, 10-3-1110, 10-4-404, and 10-4-404.5, C.R.S., states, in part:

Section 5. Rules...

C. Rule Filing General Requirements...

2. Every property and casualty company, including those writing workers' compensation and title insurance, is required by this regulation to provide a list of minimum premiums, schedule of rates, rating plans, dividend plans, individual risk modification plans, deductible plans, rating classifications, territories, rating rules, rate manuals and every modification of any of the foregoing which it proposes to use. Such filings must state the proposed effective date thereof, and indicate the character and extent of the coverage contemplated.

In late 2001, NCCI filed by month adjustment factors for 2002 unexpired portions of outstanding policies due to updates to Colorado's Medical Fee Schedule.

The following charts illustrate the significance of errors versus the populations and samples examined:

**WORKERS' COMPENSATION POLICIES WITH EXPERIENCE MODIFIERS WRITTEN  
JULY 1, 2001 TO JUNE 30, 2002**

<b>Population</b>	<b>Sample Size</b>	<b>Number of Exceptions</b>	<b>Percentage to Sample</b>
182	50	20	40%

An examination of fifty (50) audited policies with experience modifiers, representing 27% of all workers' compensation audited policies with experience modifiers which contained Colorado exposures written by the Company during the period July 1, 2001 to June 30, 2002, showed twenty (20) exceptions (or 40% of the sample) in which policies did not contain the by month adjustments for unexpired portions in 2002 filed by NCCI due to updates to Colorado's medical fee schedule.

**WORKERS' COMPENSATION POLICIES WITHOUT EXPERIENCE MODIFIERS WRITTEN  
JULY 1, 2001 TO JUNE 30, 2002**

<b>Population</b>	<b>Sample Size</b>	<b>Number of Exceptions</b>	<b>Percentage to Sample</b>
10	10	2	20%

An examination of ten (10) audited policies without experience modifiers, representing 100% of all workers' compensation audited policies without experience modifiers which contained Colorado exposures written by the Company during the period July 1, 2001 to June 30, 2002, showed two (2) exceptions (or 20% of the sample) in which policies did not contain the by month adjustments for unexpired portions in 2002 filed by NCCI due to updates to Colorado's medical fee schedule.

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**Recommendation #5**

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Sections 10-4-401, 10-3-1104, C.R.S., and Colorado Regulation 5-1-10. If the Company is unable to provide such documentation, it should be required to provide written evidence to the Colorado Division of Insurance that it will apply correct rating methodology to policies in compliance with Colorado insurance laws.

**Issue F. Failure of the Company to file its dividend plan as required by Colorado insurance law.**

Colorado Regulation 5-1-10, Rate and Rule Filing Submissions Property And Casualty Insurance, promulgated pursuant to the authority of Section 10-1-109, 10-3-1110, 10-4-404, and 10-4-404.5, C.R.S., states, in part:

Section 5. Rules...

C. Rule Filing General Requirements...

2. Every property and casualty company, including those writing workers' compensation and title insurance, is required by this regulation to provide a list of minimum premiums, schedule of rates, rating plans, **dividend plans**, individual risk modification plans, deductible plans, rating classifications, territories, rating rules, rate manuals and every modification of any of the foregoing which it proposes to use. Such filings must state the proposed effective date thereof, and indicate the character and extent of the coverage contemplated. (Emphasis added)

The Company had not filed its dividend plan used with programs underwritten by Special Risk Facilities. The eligibility for this class of dividend is that the estimated countrywide standard premium for the risk is at least \$500,000. The indicated dividend on these programs is the difference between the insured's losses, expenses, insurance charge, and profit needed and the premium otherwise earned. Dividends are paid twenty-one (21) months after inception of the policy.

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**Recommendation #6**

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Colorado Regulation 5-1-10. If the Company is unable to provide such documentation, it should be required to file any dividend plans currently in use in compliance with Colorado insurance laws.

**UNIT CARD STATISTICAL REPORTING**  
**FINDINGS**

<b>Issue G: Failure of the Company, in some cases, to correctly report unit statistical card information to NCCI.</b>
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Section 10-4-402, C.R.S., Definitions, states in part:

(3) "Rating organization" means every person, other than an admitted insurer, which has as its object or purpose the making of pure premium rates, rating plans, or rating systems...

Section 10-4-404, C.R.S., Rate administration, states in part:

(1) The commissioner shall promulgate rules and regulations which shall require each insurer to record and report its loss and expense experience and such other data, including reserves, as may be necessary to determine whether rates comply with the standards set forth in Section 10-4-403. Every insurer or rating organization shall provide such information and in such form as the commissioner may require. No insurer shall be required to record or report its loss or expense experience on a classification basis that is inconsistent with the rating system used by it. The commissioner may designate one or more rating organizations or advisory organizations to assist him in gathering and in compiling such experience and data. No insurer shall be required to record or report its experience to a rating organization unless it is a member of such organization.

NCCI's Workers Compensation Statistical Plan Manual states in part:

#### PART 4: LOSS INFORMATION

##### 7. Indemnity Incurred Amounts

- *The total of all paid and outstanding indemnity amounts.*
- ...The amount reported as incurred indemnity including all paid and outstanding benefits (vocational rehabilitation, compensation paid to the deceased prior to death, burial expenses, and payments to the state or to special funds).
- *Incurred indemnity reduced by subrogation recovery...*

(Items in italics were added March 15, 2002)

##### 8. Medical Incurred Amounts

- *The total of all paid and outstanding medical amounts*
- Reserves for future payments
- All payments to doctors and hospitals
- Physical rehabilitation costs
- Medical loss items, such as transportation expenses associated with medical treatment
- Bonuses or return-to-work incentives paid by the *carrier* to the Medical Care Provider when the policy is written with contract medical
- *Incurred medical should be reduced by subrogation recovery...*

(Items in italics were added March 15, 2002)

## 35. Deductible Reimbursement (Amount)

Report the deductible reimbursement received from the insured. Deductible reimbursements must be reported for states that require net reporting of losses for experience rating. In net experience rating states, the net loss will be calculated using the deductible reimbursement amount. All losses must be reported on a gross basis..., including losses that were reimbursed by an indemnity and/or medical deductible payment by the insured. If reimbursements are received after a first or subsequent valuation, report the reimbursement on the next valuation.

Exceptions: Colorado Statute 8-44-111, effective July 1, 1991, states that the experience rating losses must be net up to the first \$5,000 per claim in deductible reimbursement for both large and small deductible programs; therefore, report the deductible reimbursement with an upper limit of \$5,000 per claim in the Deductible Reimbursement field. *Effective with all unit statistical reports received at NCCI on January 1, 2003 or thereafter, the definition of deductible reimbursement has been amended to remove the requirement that the insurer must receive the reimbursement from the insured before reporting the deductible reimbursement. The insurer must apply the full policy deductible associated with the loss and report that deductible amount (up to the value of the incurred loss) into the Deductible Reimbursement field. The amount reported in Deductible Reimbursement remains subject to the upper limit (maximum) of \$5,000 per claim.* (Emphasis added)

The following charts illustrate the significance of errors versus the populations and sample examined:

**CLAIMS FOR WORKERS' COMPENSATION POLICIES WITH EXPERIENCE MODIFIERS  
WRITTEN JULY 1, 2001 TO JUNE 30, 2002**

Population	Sample Size	Number of Exceptions	Percentage to Sample
554	372	31	8%

An examination of 372 claims for audited policies with experience modifiers, representing 67% of all claims filed for the thirty-five (35) audited policies with experience modifiers examined that had reported claims, written by the Company during the period July 1, 2001 to June 30, 2002, showed thirty-one (31) exceptions (or 8% of the sample) in which errors occurred in reporting claims on unit statistical cards. Twenty-two (22) claims either had expense payments included with medical payments or they had been valued incorrectly. Nine (9) claims had not been reported on unit statistical cards. The maximum number of claims examined on any unit card was twenty-five (25), and these were chosen by interval sampling.

**CLAIMS FOR WORKERS' COMPENSATION DEDUCTIBLE POLICIES  
WRITTEN JULY 1, 2001 TO JUNE 30, 2002**

Population	Sample Size	Number of Exceptions	Percentage to Sample
681	493	373	76%

An examination of 493 claims for workers' compensation policies with deductibles, representing 72% of all claims filed for the fifty (50) policies with deductibles examined, written by the Company during the period July 1, 2001 to June 30, 2002, showed 373 exceptions (or 76% of the sample) and 374 instances in which claims information had not been reported correctly on unit statistical cards. 353 deductible reimbursements were not reported on the insureds' unit statistical cards. Twenty (20) claims had incorrect amounts shown in the deductible reimbursement field on unit statistical cards. One (1) claim showed an incorrect medical payment. The maximum number of claims examined on any unit card was twenty-five (25) and these were chosen by interval sampling.

The population and sample size for this sample include the claims shown above as claims for audited policies with experience modifiers. Since all of those policies had deductibles and had been examined for the reporting of deductible reimbursements (the primary purpose for choosing a deductible policy sample), the examiners felt that there was nothing of substance to be gained by pulling a complete sample of fifty (50) other deductible policies for the deductible policy sample. This was agreed to by the Company and the Colorado Division of Insurance.

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### **Recommendation #7**

Within thirty (30) days, the Company should be required to provide documentation demonstrating why it should not be considered in violation of Sections 10-4-404, C.R.S. If the Company is unable to provide such documentation, it should be required to provide written evidence to the Colorado Division of Insurance that it will correctly report unit statistical card information to NCCI in compliance with Colorado insurance laws.

It is also recommended that the Company be required to ensure that experience modification factors are recalculated by NCCI and then to apply the corrected factors to all policies whose premiums were incorrect due to the incorrect reporting of unit statistical card information, and would be reduced by applying the corrected factors.

**SUMMARY OF RECOMMENDATIONS LOCATOR**  
**EXAMINATION REPORT ON**

**PACIFIC EMPLOYERS INSURANCE COMPANY**

	<b>ISSUE</b>	<b>RECOMMENDATION</b>	<b>PAGE #</b>
<b>A</b>	Failure of the Company, in some cases, to maintain records required when writing workers' compensation policies in Colorado.	1	15
<b>B</b>	Failure of the Company to attach a form to policies which shows the potential savings available when an insured obtains cost containment certification by the Colorado Workers' Compensation Cost Containment Board and to require the insured to indicate its awareness of this program on a form and to retain this form in the insured' underwriting file.	2	18
<b>C</b>	Failure of the Company to require each insured to indicate on a form their awareness of the premium differential available when an insured selects a designated medical provider and to retain this form in the insured's underwriting file.	3	20
<b>D</b>	Failure of the Company, in some cases, to use experience modification factors promulgated by NCCI.	4	22
<b>E</b>	Failure of the Company, in some cases, to apply the correct rating methodology when rating workers' compensation policies with Colorado exposures.	5	24
<b>F</b>	Failure of the Company to file its dividend plan as required by Colorado insurance law.	6	25
<b>G</b>	Failure of the Company, in some cases, to correctly report unit statistical card information to NCCI.	7	29

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participated in this examination and in the preparation of this report.